EU summit 17-21 July - White smoke at the end

Summary

The European Council meeting that almost broke the all-time record for its length (held by Nice 2000), resulted in a compromise that allowed all factions to claim victory in the end. While a detailed reading of the Council conclusions may lead to second thoughts on all sides, the summit will likely prove to be one of the defining moments of the European Union's history. For the first time, the EU will use its own budget to engage in fiscal stimulus. Euro-denominated assets issued to finance the recovery plan may help promote the euro as an international currency. The compromise reached at the meeting also opens the door for adding new financial resources to the EU budget, starting with a plastic waste tax from January 2021, as the need to repay recovery loans will create pressure for more income.

Success for all

This month's European Council was planned for two days starting Friday, 17 July in the morning. In the end, it took four days and almost four nights before an agreement was reached late on Tuesday night. The leaders that had at various points threatened to impose vetoes or to leave Brussels (especially, French President Emmanuel Macron), emerged from the "Europa" building with blurry eyes but looking as if they had all won.

- The "**Frugals**" (Netherlands, Austria, Sweden, Denmark – occasionally joined by Finland) that had been the source of much of the controversy were content. They had succeeded in reducing the amount of grants on offer in the European Commission's recovery programme to regions and sectors hardest hit by the economic consequences of COVID-19 from EUR 500bn to EUR 390bn They also pushed through an "emergency break" mechanism that allows any single EU country to trigger a discussion in future European Council meetings if a recipient country is considered to deviate from benchmarks established in national support programmes. Finally, they gained generous rebates on their budget contributions.
- The main **beneficiaries** (especially Italy, Spain, Greece, and Portugal) were happy that the worst – a failure to reach agreement – had been avoided. While the amount of money for grants had been reduced, this largely affects programmes benefitting all member states. The grant element in the instrument that was most important to them - the Recovery and Resilience programme for macro-economic support – was even increased by EUR 100bn. Even **Italy**'s Prime Minister Giuseppe Conte has started to see the value of cheap 25-year loans without strict macroeconomic conditions ("no troika"). **Dutch** Prime Minister Mark Rutte can trigger his European Council debate but ultimately the Commission will decide if a government has fulfilled its reform promises.

- **Hungary**'s Prime Minister Viktor Orban was satisfied that he had outsmarted them all: By threatening to end the summit over the possible rule-of-law conditionalities attached to the budget, he obtained generous budgetary support and at the same time avoided a conditionality that would have seen less money going to Budapest. Instead, the European Council agreed to re-visit the rule-of-law issue at a later date. The can was – once more - kicked down the road.
- **French** President Macron and **German** Chancellor Angela Merkel were happy that their joint initiative in May on a recovery fund had been a success, and avoided a financial crisis in Europe in addition to the economic one, which could very well have been the result if the summit had ended in a failure.
- And **European Council President** Charles Michel must have been very grateful that his compromise efforts had succeeded this time (discretely supported by Merkel) and would erase the image of failure which had plagued him since his attempt in February to conclude the financial package.

A historic event

A closer reading of the 60-page conclusion text over the coming days may bring some second thoughts. For the Frugals, the price for their budget cuts was a reduction in EU expenditures across the board, including in policies close to their heart like research, digital, climate change, development aid and more. Also, their lack of understanding for the seriousness of the challenges facing the hardest hit countries has probably not enlarged their group of friends, using up a lot of diplomatic capital in Brussels. With the departure of the UK, and Germany taking a different direction on some aspects of economic policy, they could struggle to find coalition partners in crucial areas like competition policy, internal market or trade policy when such issues come up for decision.

At the same time, Italy and other main beneficiaries will need to understand that many critical eyes across Europe – not just the Frugals – will carefully watch their domestic spending. A historic window of opportunity exists now to modernise the Italian economy.

Orban and Polish Prime Minister Mateusz Morawiecki should not believe that the rule of law issue will go away since it touches on the core of the European construction.

However, these considerations should not overshadow the fact that the summit was a defining moment in EU's history for several reasons:

- The agreement on the seven-year **Multiannual Financial Framework** (MFF) of EUR 1,072bn showed that it was possible to fill the hole left by the UK's departure and continue the modernisation of the budget at the same time.
- An unprecedented act of **solidarity** was shown to Member States most affected by the economic fallout of COVID-19. The support level could amount to **10-15%** (grants and loans) of their GDP. The successful Marshall Plan in its time corresponded on average to 3% of GDP

- For the first time in history the **EU will engage directly in fiscal stimulus** using its own budget, and do so to an extent that is macroeconomically significant. The EU will use **deficit spending** financed by EU bonds floated on the market.
- The EU-bonds originating from the recovery package, as well as the recently adopted loan instruments, (SURE, EIB-guarantees to SMEs and EMS's COVID-19 facility) could provide the **safe euro-dominated asset** that has been lacking in promoting the euro as an international currency.
- The compromise opens the door for adding **new financial resources** to the EU budget, starting with a plastic waste tax from January 2021. The need to pay back the recovery loan will add to the pressure for more such resources. Moreover, the flexibility clauses inserted into the seven-year MFF – like the prolongation of the time allowed for implementing EU projects after they have been decided – will have similar effect. This could carry forward a considerable overhang of outstanding obligations to the next financial perspective (after 2027) that will also need to be financed.

Finally, despite the tense moments during the European Council, the EU showed this week that it is capable of acting together when needed. It also showed that in times of crisis it is the EU, and not China, the United States nor any single European country for that matter, that holds the key to resolving complex common problems.